NIKE SALES MALAYSIA SDN BHD A

v.

JABATAN KASTAM DIRAJA MALAYSIA & ANOR

FEDERAL COURT, PUTRAJAYA B
ZULKEFLI AHMAD MAKINUDIN CJ (MALAYA)
SURIYADI HALIM OMAR FCJ
AHMAD MAAROP FCJ
HASAN LAH FCJ
ZALEHA ZAHARI FCJ C
[CIVIL APPEAL NO: 01-3-03-2012(W)]
29 MAY 2013

CUSTOMS AND EXCISE: *Customs duty - Valuation of goods - Royalties - Whether to be included as part of paid or payable price of goods - Whether considered as condition of sale for goods to be exported to Malaysia - Whether valid adjustment item - Whether to be added to transaction value of imported goods - Customs (Rules of Valuation) Regulations 1999, regs. 4, 5(1)(a)(iv)* D

Nike Sales Malaysia Sdn Bhd ('the plaintiff') imported into Malaysia footwear, apparel, sports equipment and accessories under the Nike brand ('the licensed goods'). Nike Inc (USA) ('Nike USA') was the ultimate holding company of Nike International Ltd ('the licensor') and the plaintiff. The Royal Malaysian Customs Department ('the first defendant'), after carrying out an audit exercise on the declared value of goods imported by the plaintiff, ruled out that the audit examination showed that the royalty cost was not included as part of the paid, or payable price of the goods. A letter of demand dated 15 August 2003 was therefore issued by the first defendant to the plaintiff demanding payment of RM3,292,076.91 (which was subsequently reduced to RM2,675,344.19) as customs duties and sales tax payable by the plaintiff under reg. 5(1)(a)(iv) of the Customs (Rules of Valuation) Regulations 1999 ('the Regulations'). The plaintiff lodged an appeal to the Director General of Customs Malaysia ('the second defendant') which was dismissed. Hence, the plaintiff appealed to the High Court. The plaintiff argued that the royalties were not paid as a condition of the sale of the goods for export to Malaysia because the sale contract and the royalties contract were separate agreements made between different parties and that the party to whom the royalties were payable, Nike International Ltd, did not have control of the situation in E F G H I

A Malaysia beyond the ordinary rights of a licensor of intellectual property. The Judicial Commissioner ('JC'), after carefully considering the decisions from the Commonwealth countries on this issue, had agreed with the views expressed in the case of *Deputy Minister of National Revenue v. Mattel Canada Inc* ('*Mattel*
B *Canada*') and allowed the plaintiff's appeal. The Court of Appeal, however, had agreed with the decision in *Chief Executive of New Zealand Customs Service v. Nike New Zealand Ltd* ('*Nike New Zealand*') and in reversing the decision of the JC, held that the royalties payable by the plaintiff after the goods were sold were
C to be regarded as an item to be included for adjustment of the price to be paid or payable. Thus, the plaintiff appealed. The questions for which leave to appeal to this court were granted were (i) whether the royalty paid by the plaintiff to Nike International Ltd could be considered as a condition of sale for
D the goods to be exported to Malaysia and as an item for the adjustment in accordance with r. 4 of the Regulations read together with r. 5(1)(a)(iv) of the said Regulations; and (ii) whether the royalty was an indirect consideration by the plaintiff as a condition of sale for the entry of the goods to be
E exported into Malaysia.

Held (allowing appeal with costs; setting aside orders of Court of Appeal; reinstating orders of the High Court)
Per Hasan Lah FCJ delivering the judgment of the court:

F **(1)** The royalties paid by the plaintiff should not be included for duty purposes since the plaintiff did not have to pay any royalty in order to purchase the licensed goods from the suppliers. The obligation to pay royalty only arose from a
G separate agreement unrelated to the sale for export of the goods to Malaysia. The test adopted by the JC was therefore correct. (para 43)

(2) The JC had not erred in holding that royalty payable by Nike Malaysia to Nike International could not properly be taken as
H an adjustment item under reg. 5(1)(a)(iv) of the Regulations. Clause 13.1 of the Intellectual Property License and Exclusive Distribution Agreement clearly stated that Nike International Ltd should not prevent or impede the sale of goods exported into Malaysia despite non-payment of royalty. Nike
I International Ltd did not have control of the situation in Malaysia beyond the ordinary rights of a licensor of intellectual property and giving it the ability to determine whether export to Malaysia could or could not occur. (para 44)

(3) The decision given in the judgment of the Canadian Supreme Court in the case of *Mattel Canada* was consistent with the relevant advisory opinions given by the Technical Committee on Customs Valuation. Due regard must be given to such advisory opinions because the interpretation of regs. 4 and 5 of the Regulations could not be an isolated and domestic exercise. It is pertinent to note that in other Commonwealth countries like the United Kingdom, Australia, India and Singapore, royalties paid on Nike goods have not been taken to be part of the value of imported goods for purposes of imposing duties and sales tax. As such, the decision in (*Nike New Zealand*) must be viewed as being inconsistent with the treatment in other Commonwealth countries. (para 45)

(4) It is the requirement of reg. 5(1)(a)(iv) of the Regulations that the royalties must be paid directly or indirectly as a condition of the sale of the goods for export to Malaysia in order for an adjustment to be made to the transaction value of the imported goods by adding the royalties. Since royalties paid by the plaintiff to Nike International Ltd were not expressed to be paid as a condition of sale for the export of the goods by the independent foreign suppliers to the plaintiff, the royalties were therefore not to be added to the transaction value of the imported goods. (para 47)

Bahasa Malaysia *Translation Of Headnotes*

Nike Sales Malaysia Sdn Bhd ('plaintif') telah mengimport kasut, pakaian, peralatan dan aksesori sukan ke Malaysia di bawah jenama Nike ('barang-barang berlesen'). Nike Inc (USA) ('Nike USA') adalah syarikat induk Nike International Ltd (pemberi lesen) dan plaintif. Jabatan Kastam Diraja Malaysia ('defendan pertama'), selepas menjalankan audit nilai barang yang diisytiharkan telah diimport oleh plaintif, memutuskan bahawa pemeriksaan audit menunjukkan kos royalti tidak dimasukkan sebagai sebahagian daripada yang jumlah dibayar, atau harga barang yang harus dibayar. Satu surat tuntutan bertarikh 15 Ogos 2003 telah dikeluarkan oleh defendan pertama kepada plaintif menuntut bayaran RM3,292,076.91 (yang pada kemudiannya dikurangkan ke RM2,675,344.19) sebagai duti kastam dan cukai jualan yang perlu dibayar oleh plaintif di bawah perkara 5(1)(a)(iv) Peraturan-Peraturan Kastam (Kaedah Penilaian) 1999 ('Peraturan'). Rayuan plaintif kepada Ketua Pengarah Kastam Malaysia ('defendan kedua') telah ditolak. Oleh itu, perayu membuat rayuan ke

Mahkamah Tinggi. Plaintif menghujahkan bahawa royalti tidak dibayar sebagai syarat jualan barang-barang untuk eksport ke Malaysia kerana kontrak jualan dan kontrak royalti adalah perjanjian yang berasingan yang dibuat antara pihak-pihak yang berbeza dan pihak yang menerima bayaran royalti, Nike International Ltd, tidak mempunyai kawalan melebihi hak-hak biasa seorang pemberi lesen harta intelektual di Malaysia. Pesuruhjaya Kehakiman ('PK'), selepas mempertimbangkan dengan teliti keputusan-keputusan daripada negara-negara Komanwel lain berkenaan isu ini, telah bersetuju dengan pandangan-pandangan yang terdapat dalam kes *Deputy Minister of National Revenue v. Mattel Canada Inc* (*'Mattel Canada'*) dan membenarkan rayuan plaintif. Mahkamah Rayuan, walau bagaimanapun, telah bersetuju dengan keputusan *Chief Executive of New Zealand Customs Service v. Nike New Zealand Ltd ('Nike New Zealand')* dan dalam mengakas keputusan PK, memutuskan bahawa royalti yang harus dibayar oleh plaintif selepas barang-barang dijual adalah dianggap sebagai item yang harus dimasukkan bagi pelarasan harga yang dibayar atau harus dibayar. Oleh itu, perayu merayu. Persoalan-persoalan yang timbul dalam rayuan ini adalah (i) sama ada royalti yang dibayar oleh plaintif kepada Nike International Ltd boleh dianggap sebagai syarat jualan barang-barang untuk dieksport ke Malaysia dan sebagai item untuk pelarasan menurut perkara 4 Peraturan dibaca bersama dengan perkara 5(1)(a)(iv) Peraturan tersebut; dan (ii) sama ada royalti adalah satu pertimbangan tidak langsung oleh plaintif sebagai syarat jualan kemasukan barang-barang untuk eksport ke dalam Malaysia.

Diputuskan (membenarkan rayuan dengan kos; mengenepikan perintah Mahkamah Rayuan; menghidupkan semula perintah Mahkamah Tinggi)

Oleh Hasan Lah HMP menyampaikan penghakiman mahkamah:

(1) Royalti yang dibayar oleh plaintif tidak perlu dimasukkan untuk tujuan duti kerana plaintif tidak membayar royalti untuk membeli barang-barang berlesen daripada pembekal. Kewajipan membayar royalti hanya timbul daripada perjanjian yang berasingan yang tiada kaitan dengan jualan eksport barang-barang ke Malaysia. Ujian yang diguna pakai oleh PK adalah betul.

(2) PK tidak khilaf apabila memutuskan bahawa royalti yang dibayar oleh Nike Malaysia kepada Nike International tidak boleh dianggap sebagai item pelarasan di bawah perkara 5(1)(a)(iv) Peraturan. Klausa 13.1 Lesen Harta Intelek dan Perjanjian Pengedaran Eksklusif dengan jelasnya menyatakan bahawa Nike International Ltd tidak boleh mencegah atau menghalang jualan barang-barang yang dieksport ke Malaysia walaupun tiada pembayaran royalti. Nike International Ltd tidak mempunyai kawalan melebihi hak-hak biasa seorang pemberi lesen harta intelektual di Malaysia atau keupayaan untuk menentukan sama ada eksport ke Malaysia boleh atau tidak boleh berlaku.

(3) Keputusan dalam penghakiman Mahkamah Agung Kanada dalam kes *Mattel Canada* adalah konsisten dengan pendapat-pendapat penasihat-penasihat relevan yang diberikan oleh Jawatankuasa Teknikal Penilaian Kastam. Perhatian yang sewajarnya harus diberikan kepada pendapat-pendapat penasihat-penasihat tersebut kerana tafsiran-tafsiran perkara 4 dan 5 Peraturan tidak boleh menjadi satu usaha yang terpencil dan domestik. Adalah penting untuk ditekankan bahawa di negara-negara Komanwel yang lain seperti United Kingdom, Australia, India dan Singapura, royalti yang dibayar ke atas barang-barang Nike tidak dikira sebagai sebahagian nilai barang-barang import bagi tujuan mengenakan duti dan cukai jualan. Oleh itu, keputusan *Nike New Zealand* harus dilihat sebagai tidak konsisten dengan apa yang dilaksanakan di negara-negara Komanwel yang lain.

(4) Adalah keperluan perkara 5(1)(a)(iv) Peraturan bahawa royalti harus dibayar secara langsung atau tidak langsung sebagai syarat jualan barang-barang untuk eksport ke Malaysia bagi membolehkan pelarasan dibuat kepada nilai transaksi barang-barang yang diimport dengan menambah royalti. Oleh kerana royalti yang dibayar oleh plaintif kepada Nike International Ltd tidak dinyatakan akan dibayar sebagai syarat jualan eksport barang-barang oleh pembekal asing bebas kepada plaintif, royalti oleh itu tidak boleh ditambah kepada nilai urus niaga barang yang diimport.

Case(s) referred to:

Chief Executive of New Zealand Customs Service v. Nike New Zealand Ltd [2004] 1 NZLR 238 ***(not foll)***

Deputy Minister of National Revenue v. Mattel Canada Inc [2001] 199 DLR (4th) 598 ***(foll)***

National Land Finance Co-operative Society Ltd v. Director-General of Inland Revenue [1993] 4 CLJ 339 SC ***(refd)***

Legislation referred to:

Customs Act 1967, ss. 2, 143A

Customs (Amendment) Act 2007, s. 10(3)

Customs (Rules of Valuation) Regulations 1999, rr. 4(1), 5(1)(a)(iv)

Canadian Customs Act 1985 [Canada], s. 48(5)

For the appellant - KI Goh (Foong Pui Chi with her); M/s Shearn Delamore & Co

For the respondent - Noor Hisham Ismail, SFC

[Appeal from Court of Appeal; Civil Appeal No: W-01(IM)-123-09I]

Reported by Suhainah Wahiduddin

JUDGMENT

Hasan Lah FCJ:

Introduction

[1] This is an appeal by the appellant against the decision of the Court of Appeal dated 8 March 2011 which allowed the respondents appeal against the decision of the High Court dated 9 April 2009.

[2] The appellant was the plaintiff in the High Court and the respondents were the defendants. We shall refer to the parties herein as they were before the High Court.

[3] The questions for which leave to appeal to this court were granted are as follows:

Question 1

Whether the royalty paid by the applicant/appellant to Nike International Ltd could be considered as a condition of sale for the goods to be exported to Malaysia and as an item for

the adjustment in accordance with r. 4 of the Customs (Rules of Valuation) Regulations 1999 read together with r. 5(1)(a)(iv) of the said Regulations?

Question 2

Whether the royalty is an indirect consideration by the applicant/appellant as a condition of sale for the entry of the goods to be exported into Malaysia?

Background Facts

[4] The relevant facts of the case had been amply set out by the learned Judicial Commissioner in his grounds of judgment. For the purpose of this appeal we find it sufficient to reproduce the relevant facts of this case as found by him. They are as follows.

[5] The Post - Import Audit Division of the Jabatan Kastam Diraja Malaysia, Wilayah Persekutuan, Kuala Lumpur, carried out an audit exercise on the declared value of goods imported by Nike Sales Malaysia Sdn Bhd (the plaintiff) between January 2000 to February 2003. The plaintiff imported into Malaysia footwear, apparel, sports equipment and accessories under the Nike brand ("the licensed goods"). The audit examination showed royalty cost was not included as part of the paid, or payable price of the goods.

[6] The basic relationship between the parties in the business transaction is as follows. Nike Inc (USA) ("Nike USA") is the ultimate holding company of Nike International Ltd and the plaintiff. Nissho Iwai American Corporation ("NIAC") is an independent unrelated third-party that acts as a buying and trade financing agent. The manufacturers/suppliers who export the goods to the plaintiff through the intermediation of Nike USA and NIAC are unrelated, independent third party. The plaintiff is under an obligation to pay royalty, based on net invoiced sales, to Nike International Ltd, the licensor.

[7] There are three inter-related agreements governing this business transaction, namely:

(a) a purchase commission agreement;

(b) an amended and restated buying agency and logistics services agreement; and

(c) an intellectual property licence and exclusive distribution agreement.

[8] Clause 2.1.1. of the purchase commission agreement made between the plaintiff and Nike USA, the parent company in USA, provides:

> NIKE [Nike Inc] shall receive purchase orders from Participating Company [Nike Malaysia] for products and shall place such orders with its selected foreign manufacturers. NIKE shall order such products at favourable prices in accordance with the requirements of the Participating Company with respect to type, quantity, delivery, deadlines, financing and insurance. NIKE shall deliver such products, or arrange for their delivery, to such ports as the Parties may from time to time determine. NIKE shall act in its own name, for the account of the Participating Company, but shall have authority to represent and bind Participating Company *vis-à-vis* foreign manufacturers.

[9] The amended and restated buying agency and logistics services agreement was an agreement made between the plaintiff and Nissho Iwai American Corporation ("NIAC") for NIAC to provide:

> 3.1. Buying Agency Services, including the purchase of Goods from Suppliers on behalf of NIKE on a disclosed principal basis;
>
> 3.2. Trade Financing, including the payment of funds on behalf of NIKE (which are treated as reimbursable costs.) to L/C Issuers, suppliers, transportation companies, third party logistics providers, Insurers, custom brokers, and government authorities (e.g. customs authorities) as directed by NIKE;
>
> 3.3. L/C and Payment Process Management, including the application for, amendment of, payment under, and tracking of L/C's or open account purchases on behalf of NIKE on a disclosed principal basis in accordance with NIKE's instructions; and
>
> 3.4. Recordkeeping and Documentation Services, including but not limited to generation, communication and consolidation of purchase orders and invoices (including electronic file generation and communication), review and tracking of shipping documentation, compliance with Customs and other Government agency requirements, and warehousing of data relating to the Services.

[10] The intellectual property licence and exclusive distribution agreement was an agreement made between the plaintiff and Nike International Ltd, the licensor. Under the agreement the plaintiff was granted, *inter alia*:

> ... a non-transferable and non-exclusive licence to manufacture or subcontract for the manufacture of licensed goods using the Trademarks and Other Proprietary Rights ...
>
> ... a non-transferable and exclusive licence (i) to sell licensed goods in the Licensed Territory and (ii) to use the Trademarks and Other Proprietary Rights in the licensed Territory in connection with the advertising, marketing and sale of licensed goods ...

[11] In return for the licence to manufacture or subcontract for the manufacture of the licensed goods and the licence to sell the licensed goods, the plaintiff, as the licensee, had to pay Nike International Ltd royalty of 6% of the net invoiced sales revenue of all licensed goods sold in Malaysia.

[12] Clause 13.1 of the intellectual property licence and exclusive distribution agreement provides:

> Licensee shall have the right to subcontract for the manufacture of licensed goods and shall be free to choose the suppliers with whom it so subcontracts. The parties agree that licensor shall impose no restrictions on licensee's choice of such suppliers. The parties further agree that in the event of non-payment of the royalty provided under section 10, licensor shall not prevent or impede such supplier from selling to licensee licensed goods manufactured pursuant to binding orders accepted by such supplier prior to such supplier's receipt of notice of termination of this agreement; provided, however, that this provision shall not restrict licensor from asserting against licensee any claims that licensor may have against licensee under this agreement or otherwise.

[13] The main issue in this appeal is whether royalty should form part of the value of the goods imported by the plaintiff for purposes of imposing customs duties and sales tax. Under s. 2 of the Customs Act 1967 ("the Act"), the term 'value' is defined as follows: ' "value" in relation to imported goods means customs value as determined under s. 142(35B)'. Under s. 142(35B) the Minister may make regulations to determine the customs value of imported goods. Accordingly, the Minister has made the Customs (Rules of Valuation) Regulations 1999.

[14] Regulation 4(1) of the Customs (Rules of Valuation) Regulations 1999 ("the Regulations") provides:

> (1) The customs value of imported goods shall be their transaction value, that is, the price paid or payable for the goods when sold for export to Malaysia, adjusted in accordance with Regulation 5.

Regulation 5(1)(a)(iv) of the Regulations then provides the adjustment elements in determining the transaction value under reg. 4 of the Regulations, providing as follows:

> (1) In determining the transaction value of imported goods under Regulation 4, the price paid or payable for the goods shall be adjusted:
>
> (a) by adding thereto amounts, where such amount is not already included in the price paid or payable for the goods, determined on the basis of sufficient information, equal to:
>
> …
>
> (b) royalties and licence fees, including payments for patents, trademarks and copyrights in respect of the goods that the buyer must pay, directly or indirectly, as a condition of the sale of the goods for export to Malaysia, exclusive of charges for the rights to reproduce the goods in Malaysia.

[15] Regulation 5 of the regulations was adopted from the agreement on implementation of art. VII Of The General Agreement On Tariffs and Trade 1994 ("WTO valuation agreement"). This same regulation can be found in the customs legislations of the many countries which are signatories to the WTO valuation agreement and the leading cases on this issue are the decision of the Canadian Supreme Court in *Deputy Minister of National Revenue v. Mattel Canada Inc* [2001] 199 DLR (4th) 598 ("*Mattel Canada*") and the decision of the New Zealand Court of Appeal in *Chief Executive of New Zealand Customs Service v. Nike New Zealand Ltd* [2004] 1 NZLR 238 ("*Nike New Zealand*").

[16] The 1st defendant's view was that the royalty cost was a "transaction condition" for the imported goods for the purpose of customs valuation. A letter of demand dated 15 August 2003 was therefore issued by the 1st defendant to the plaintiff demanding

the payment of RM3,292,076.91 as custom duties and sales tax payable by the plaintiff under reg. 5(1)(a)(iv) of the regulations. This figure was reduced subsequently to RM2,675,344.19.

[17] The plaintiff lodged an appeal to the 2nd defendant which was dismissed. Hence, the plaintiff, pursuant to s. 143A of the Customs Act 1967 and by virtue of a transitional provision in s. 10(3) of the Customs (Amendment) Act 2007, appealed to the High Court against the 2nd defendant's decision.

[18] As rightly pointed out by the learned Judicial Commissioner the main issue in the appeal before him turned on the central question whether royalty cost should form part of the value of the goods to be assessed for customs duties and sales tax, bearing in mind the relevant provisions in the relevant Act and the regulations. The issue involved a question of interpretation of these provisions.

[19] The plaintiff contended that the royalties were not paid as a condition of the sale of the goods for export to Malaysia because the sale contract and the royalties contract were separate agreements made between different parties. The sale contract was entered into between the plaintiff and independent subcontractors (not related to Nike International Ltd or the Nike group of companies) whilst the royalties contract were entered into between the plaintiff and Nike International Ltd. The plaintiff argued that the party to whom the royalties were payable, Nike International Ltd, did not have control of the situation in Malaysia beyond the ordinary rights of a licensor of intellectual property and giving it the ability to determine whether export to Malaysia could or could not occur because cl. 13.1 of the intellectual property licence and exclusive distribution agreement clearly specified that Nike International Ltd shall not prevent or impede the sale of goods exported into Malaysia despite non-payment of royalty.

[20] The defendants, on the other hand, contended that the royalties paid had to be included in the customs value since the royalties were, directly or indirectly, a condition of the sale of the licensed goods for export to Malaysia.

[21] In his decision the learned Judicial Commissioner, after having carefully considered the decisions from the Commonwealth countries on this issue especially in *Mattel Canada* and *Nike New*

Zealand and the relevant advisory opinions given by the Technical Committee on Customs Valuation ("TCCV") established under the WTO valuation agreement of which Malaysia is a signatory, held that the royalty payable by the plaintiff to Nike International Ltd could not properly be taken as a "condition of the sale of the goods for export to Malaysia" and as an adjustment item under reg. 4 read in conjunction with reg. 5(1)(a)(iv) of the regulations.

[22] In arriving at his decision the learned Judicial Commissioner applied the following test:

> The overriding test is whether the buyer or importer has, or has not, the obligation to pay the royalty in order to purchase or import the goods. If the obligation arises from a separate agreement that is unrelated to the sale or importation of the goods, it cannot be regarded as a condition of the sale of the goods.

[23] The learned Judicial Commissioner found that on the facts of the instant case it could not be said that the licence agreement and the contract of sale comprised one single transaction. The transaction mechanism adopted by the parties was simply too complex, whether in form or in substance, for this conclusion to be made. In other words he agreed with the views expressed in *Mattel Canada*. The appeal by the plaintiff was accordingly allowed.

[24] On appeal to the Court of Appeal the decision of the learned Judicial Commissioner was reversed by the Court of Appeal. The Court of Appeal agreed with the majority decision in *Nike New Zealand* and held that the royalties payable by the plaintiff to Nike International Ltd after the goods were sold were to be regarded as an item to be included for adjustment of the price to be paid or payable.

[25] In his judgment, KN Segara JCA, speaking for the court, observed that:

> Nike Inc. is the ultimate holding company of Nike International Ltd. and Nike Sales Malaysia Sdn Bhd (Respondent). Nissho Iwai American Corporation (NIAC) is a wholly owned subsidiary of Nissho Iwai Corporation (NISSHO). Nissho is an independent unrelated third-party that acts as a buying and trade finance agent. Manufacturer/Suppliers export the goods to the respondent, through the intermediation of Nike Inc and NISSHO. The respondent is under an obligation to pay royalty, based on net invoiced sales to NIL. However, the price paid or payable by the

respondent to the manufacturers/suppliers for the goods exported to the respondent is invoiced without taking into consideration the obligatory royalty element payable to NIL by the respondent, pursuant to the Intellectual Property License and Exclusive Distribution Agreement between NIL, as the licensor, and the respondent, as the licensee. We are unanimous in our view that under such circumstances it would be legally wrong not to make an adjustment for the price paid or payable merely because it was not expressed that the respondent must pay the said royalty as a condition of the sale of the goods for export to Malaysia. Such a proposition appears to us to be an ingenious attempt to evade the proper customs duty on the imported goods by the respondent.

The Appeal

[26] In her submission learned counsel for the plaintiff submitted that the decision in *Mattel Canada*, which was consistent with the decisions in the other leading cases decided in the Commonwealth (except New Zealand) and the advisory opinions given by TCCV, ought to be relied upon and followed.

[27] Learned Federal Counsel, the solicitors for the defendants, argued that since the payment of royalty in the intellectual property licence and exclusive distribution agreement was the *sine quo non* for the use of the rights, then the payment of the royalty must be the condition of the sale on the licensed goods that were manufactured and exported to Malaysia. It was also the contention of the defendants that the transactions of buying the licensed goods by the plaintiff from the manufacturers through another company and subsequently made the royalty payment after the goods were sold showed that the royalty paid was actually or indirectly paid in respect of the licensed goods exported to Malaysia.

[28] The defendants also contended that based on the intellectual property and exclusive distribution agreement the plaintiff was fully aware that the goods manufactured on their behalf carried a trademark of the Nike International Ltd and fully aware that the goods that were manufactured would be subjected to royalty after the goods were sold later.

[29] To fortify their argument the defendants cited *Nike New Zealand* where the facts with regard to the business transaction and the provisions of the regulations referred in the case are very much similar to the instant case.

[30] With regard to the relevant advisory opinion given by the TCCV learned Senior Federal Counsel submitted that such opinion was not conclusive as the royalty that was paid by the plaintiff on the facts of this case should be regarded as a condition of sale in respect of the goods manufactured and exported to Malaysia.

[31] As mentioned earlier two leading cases were submitted as persuasive authorities namely, *Mattel Canada* and *Nike New Zealand*. It is therefore pertinent to consider the reasonings adopted by the courts in Canada as against the courts in New Zealand.

[32] In *Mattel Canada* the facts bear similarities with the facts in the instant case in that the royalties were paid to a different party from the manufacturer of the goods and the royalties paid were based on the net invoiced sales of goods in Canada. Mattel Canada Inc was a wholly owned subsidiary of Mattel Holdings Limited which in turn was a wholly owned subsidiary of Mattel Inc. Mattel Inc owned Mattel Trading Company Limited, the intermediary. Mattel Canada Inc ordered goods through a computer system owned by Mattel Inc. The goods were manufactured in Hong Kong by foreign manufacturers (some of whom were part of the Mattel group), who invoiced Mattel Trading Company Ltd, Mattel Trading Company Ltd, who in turn then invoiced Mattel Canada Inc, Mattel Canada Inc, had to pay royalties to the trade mark licensor, Licensor X, based on a certain percentage of Mattel Canada Inc's net invoiced billings for goods sold to Canadian customers.

[33] The main issue in *Mattel Canada*, as in this case, was whether the payments of royalties were paid by the purchaser of the goods exported into Canada directly or indirectly as a condition of the sale of the goods exported into Canada.

[34] In determining whether royalties were paid "as a condition of sale of the goods for export to Canada in accordance with s. 48(5) of the Canadian Customs Act 1985 (which is similar to our reg. 5(1)(a)(iv) of the regulations) the Canadian Supreme Court, at p. 617, held:

> [58] A condition of sale has a settled legal meaning. P.S. Atiyah's textbook, *The Sale of Goods*, 8th edn. (1990), states that "in its usual meaning a condition is a term which, without being the fundamental obligation imposed by the contract, is still of such vital importance that it goes to the root of the

transaction" (at p. 60). Professor Atiyah later adds that "[t]he importance of a condition in contracts for the sale of goods is that its breach, if committed by the seller, may give the buyer the right to reject the goods completely and to decline to pay the price, or if he has already paid it, to recover it" (at p. 60 (citation omitted)). Ontario's Sale of Goods Act, R.S.O. 1990, c. S.1, makes frequent reference to conditions of sale.

[59] Rather than create a complex series of tests not strictly based on the settled legal meaning of words, it is preferable to rely on the common law and sale of goods law to determine whether royalties and licence fees are paid "as a condition of the sale of the goods for export to Canada" in accordance with s. 48(5)(a)(iv) of the Customs Act. The Court of Appeal erred when it concluded that "the word 'condition' is not use in the Act as a term of art which carries the meaning generally ascribed to it in the law of sales" (at p. 297) [para 26].

[35] The Canadian Supreme Court held that the royalties were not paid as a condition of sale because even if Mattel Canada Inc were to refuse to pay royalties to Licensor X, Mattel Inc could not refuse to sell the licensed goods to Mattel Canada Inc or repudiate the contract of sale. This was because the sale contract and the royalties contract were separate agreements between different parties.

[36] The Canadian Supreme Court, at p. 619, further held:

[67] Similarly, the royalty payments are not caught by s. 48(5)(a)(iv) merely because the subparagraph uses the words "directly or indirectly". While the adverbs do modify the verb "pay", and therefore indicate that royalties paid to third parties may be captured by s. 48(5)(a)(iv), adverbs cannot modify nouns like "condition". Therefore, the words "directly or indirectly" do not modify the requirement that royalties must be paid "as a condition of the sale of the goods for export to Canada" to be dutiable.

[68] In summary, s. 48(5)(a)(iv) requires that royalties and licence fees be paid "as a condition of the sale of the goods for export to Canada". The words incorporate traditional concepts found in sale of goods legislation and the common law of contract. Unless a vendor is entitled to refuse to sell licensed goods to the purchaser or repudiate the contract of

A sale where the purchaser fails to pay royalties or licence fees, s. 48(5)(a)(iv) is inapplicable. The royalties that Mattel Canada paid to Licensor X are not royalties within the meaning of s. 48(5)(a)(iv) of the Customs Act.

B **[37]** The facts in *Nike New Zealand* are almost on all fours with the facts in the instant case. The customs issued four assessment notices in relation to the importation of goods by Nike New Zealand Ltd (Nike NZ) between 1988 and 2000. The Tariff Act 1988 required that the value of imported goods for the purpose of applying a tariff was the customs value of the goods, C determined in accordance with the second schedule to the New Zealand Customs and Excise Act 1996. Clause 3(1)(a)(iv) of the schedule provided for the price to be adjusted by adding, *inter alia*, "royalties" that the buyer had to pay "as a condition of the sale of the goods for export to New Zealand". One of the issues raised D in the case was whether certain royalties payable by Nike NZ to another subsidiary in the Nike group, Nike International Ltd. (NIL) were to be added to the value of the imported goods in assessing the value of the relevant goods. The Customs Appeal Authority held that the item should have been added. The High E Court also held that the royalties were to be added. Nike NZ appealed against the finding on the royalty question.

[38] The decision of the majority of the Court of Appeal (with Gault P dissenting), which was delivered by Blanchard J, was that F for a royalty to come within sub-para. (iv) there had to be a combination of two features. First, the royalty had to be payable to the manufacturer or to another person as a consequence of the export of the goods to New Zealand. Secondly, the party to whom the royalty was payable must have had control of the G situation going beyond the ordinary rights of a licensor of intellectual property and giving it the ability to determine whether the export to New Zealand could or could not occur. The goods bearing the licensor's trade marks were able to be exported to New Zealand only because of the existence of the licence H agreement which required the payment of a royalty. Implicitly the licence covered, and the royalties were payable for, the right to export the goods to New Zealand. Hence the payment of royalty by Nike NZ to NIL was a condition of the sale of goods for export to New Zealand in terms of cl. 3(1)(a)(iv) of the second I schedule.

[39] It is to be noted that the decision of the Supreme Court of Canada in *Mattel Canada* was considered but was not followed by Blanchard J. In fact Blanchard J was in agreement with the decision given by the Canadian Federal Court of Appeal (which was reversed by the Canadian Supreme Court). At p. 254 of the judgment Blanchard J made the following observation:

> [66] In its judgment in the *Mattel* case, subsequently reversed by the Supreme Court, the Canadian Federal Court of Appeal was of the opinion that the payment of royalties was a condition of the sale of goods for export first if it appeared as such in the contract of sale between the vendor and the importer and secondly, "if either the licensor because it owns or controls the vendor, or the vendor when it holds the trademarks rights or copyrights, can prevent the importation of the goods by the purchaser or seriously compromise the ability of the purchaser to buy the goods for export in cases where he has failed to pay the royalties". The Court pointed out that the wording of subpara (iv) does not refer to a "condition of the contract for sale" and therefore, it was, in the opinion of the Federal Court, not a requirement that the payment of royalties be expressly stipulated in the sale contract. The word "condition" was not considered to have been used in the Act as a term of art carrying the meaning generally ascribed to it in the law of sales. Rather, the word was used in its ordinary and common sense way to mean that the payment of royalties had to be made as a prerequisite or requirement for the export of the goods: para [26].
>
> [67] That view was not accepted by the Supreme Court, as we have seen, but, with respect, we find it convincing. It seems to us that for a royalty to come within subpara (iv) there must be a combination of two features. First, the royalty must be payable to the manufacturer or to another person as a consequence of the export of the goods to New Zealand and, secondly, the party to whom the royalty is payable must have a control of the situation going beyond the ordinary rights of a licensor of intellectual property and giving it the ability to determine whether to export to New Zealand can or cannot occur. An ordinary licensor, unrelated to the licensee, may be able to take steps to prevent future importations if royalties are not paid in respect of a particular importation of licensed product, but it has no control over an importation prior to any default. In contract, where royalties are payable to a licensor which is a member of the

A same corporate group as the licensee - and particularly where the buying is in practice conducted through another member of the corporate group - the situation is throughout under the parent company's control exercisable on behalf of the licensor.

B **[40]** Further, Blanchard J was of the view that the facts in *Mattel Canada* case could be distinguished. At p. 255 the learned judge said:

[70] The factual situation in Mattel was quite different. There the
C royalty was payable as a consequence of the export of goods to Canada but Licensor X had no ability to exercise control through Mattel US, the exporter. All it could do if royalties were not paid was to invoke the provision of the licensing agreement and seek to assert such rights as it had under the Canadian trade mark legislation in respect of future
D importations.

[41] Of the various advisory opinions issued by TCCV, the one closest to the facts of the instant case is advisory opinion 4.13 which is as follows:

E Importer I purchased sports bags from foreign manufacturer M, as well as from other suppliers. Importer I, manufacturer M and other suppliers are all unrelated.

Importer I, on the other hand, is related to company C which
F holds the right of a trademark. Under the terms of a contract between I and C, C transfers to the right to use the trademark to I against a royalty payment.

Importer I furnishes manufacturer M and other suppliers with labels bearing the trademark which are affixed to the sports bags
G before the importation.

Is the royalty related to the goods being valued? Does a payment from I to C form part of the condition of sale between M and I and I and other suppliers?

H The opinion expressed by TCCV was,

Although the importer is required to pay a royalty to obtain the right to use the trademark, this results from a separate agreement unrelated to the sale for export of the goods to the country of importation. The imported goods are purchased from various
I suppliers under different contracts and the payment of a royalty is not a condition of the sale of these goods. The buyer does not

have to pay the royalty in order to purchase the goods. Therefore, it should not be added to the price actually paid or payable as an adjustment under article 8.1(c).

Whether the supply of labels evidencing the trademark would qualify as dutiable under the provisions of articles 8 8.1 (B) is a separate consideration.

[42] The facts in advisory opinion 4.13 are similar to the facts of the present case in that the importer, the foreign manufacturer and other suppliers were not related parties although the importer was related to the trademark owner. The TCCV has, as one of its responsibilities, the duty "to examine specific technical problem".

[43] In our view the royalties paid by the plaintiff should not be included for duty purposes since the plaintiff did not have to pay any royalty in order to purchase the licensed goods from the suppliers. The obligation to pay royalty only arose from a separate agreement unrelated to the sale for export of the goods to Malaysia. In other words we agree with the test adopted by the learned Judicial Commissioner to determine this issue.

[44] With respect, we are unable to agree with the decision of the Court of Appeal that the learned Judicial Commissioner erred in holding that royalty payable by Nike Malaysia to Nike International could not properly be taken as an adjustment item under reg. 5(1)(a)(iv) of the Regulations. On the facts of the instant case we are in agreement with the decision of the learned Judicial Commissioner. Clause 13.1 of the intellectual property licence and exclusive distribution agreement clearly stated that Nike International Ltd, should not prevent or impede the sale of goods exported into Malaysia despite non-payment of royalty. On the facts Nike International Ltd. did not have control of the situation in Malaysia beyond the ordinary rights of a licensor of intellectual property and giving it the ability to determine whether export to Malaysia could or could not occur.

[45] We are therefore inclined to agree with the decision in *Mattel Canada* as we find that the reasons given in the judgment of the Canadian Supreme Court are more convincing. Furthermore, the decision given in *Mattel Canada* is consistent with the relevant Advisory Opinions given by the TCCV. We agree with the learned Judicial Commissioner that due regard must be given to such advisory opinions because the interpretation of regs. 4 and 5 of the regulations cannot be an isolated and domestic

exercise. It is pertinent to note that in other Commonwealth countries like the United Kingdom, Australia, India and Singapore, royalties paid on Nike goods have not been taken to be part of the value of imported goods for purposes of imposing custom duties and sale tax. As such, the decision in *Nike New Zealand* may be viewed as being inconsistent with the treatment in other Commonwealth countries.

[46] The issue in the instant case involves the interpretation of revenue/taxing statute. In this connection the Supreme Court in *National Land Finance Co-operative Society Ltd v. Director-General of Inland Revenue* [1994] 1 MLJ 99 had this to say:

> There are ample authorities to show that courts have refused to adopt a construction of a taxing Act which would impose liability when doubt exists. In Re Micklewait[9] it was held that a subject was not to be taxed without clear words. We realize that revenue from taxation is essential to enable the Government to administer the country and that the courts should help in the collection of taxes whilst remaining fair to taxpayers. Nevertheless, we should remind ourselves of the principle of strict interpretation as stated by Rowlatt J in *Cape Brandy Syndicate v. Inland Revenue Commissioners*:[1]
>
> > ... in a taxing Act one has to look merely at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to a tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used ...
>
> It has also been said by the Judicial Committee in *Oriental Bank Corp v. Wright*[10] 'that the intention to impose a charge upon a subject must be shown by clear and unambiguous language'.

[47] It is the requirement of reg. 5(1)(a)(iv) of the regulations that the royalties must be paid directly or indirectly as a condition of the sale of the goods for export to Malaysia in order for an adjustment to be made to the transaction value of the imported goods by adding the royalties. Since royalties paid by the plaintiff to Nike International Ltd are not expressed to be paid as a condition of sale for the export of the goods by the independent foreign suppliers to the plaintiff, the royalties are therefore not to be added to the transaction value of the imported goods.

[48] If the royalties are to be added in determining the transaction value of the goods exported into Malaysia regardless of whether it is expressly stated to be a condition of sale as decided by the Court of Appeal, then the words "as a condition of sale for the goods to be exported to Malaysia" would be rendered redundant as any time royalty is paid in relation to goods exported to Malaysia, royalties would be automatically added to the transaction value. If this were the true intent then the WTO valuation agreement could have easily made this intent explicit.

[49] For the reasons given we would answer both the questions posed in this appeal in the negative. Accordingly the appeal is allowed with costs. The orders of the Court of Appeal are therefore set aside. We reinstate the orders of the High Court. We will now invite counsel to address us on the issue of costs.